

and shall include a copy of the statement of disagreement in any disclosure of the record. Additionally, the Deputy Director shall provide a copy of the statement of disagreement to any person or agency to whom the record has been disclosed, if the disclosure was made pursuant to § 2504.10 (5 U.S.C. 552(a)(c)).

#### § 2504.17 Fees.

(a) Individuals will not be charged for:  
(1) The search and review of the record;  
(2) Any copies produced to make the record available for access;

(3) Copies of the requested record if access can only be accomplished by providing a copy through the mail; and

(4) Copies of three (3) or less pages of a requested record.

(b) Records will be photocopied for 10¢ per page for four pages or more (except for paragraph (a), (1), (2), (3), (4) of this section). If the record is larger than 8½×14 inches, the fee will be the cost of reproducing the record through Government or commercial sources.

(c) Fees shall be paid in full prior to issuance of requested copies. Payment shall be by personal check or money order payable to the Treasury of the United States, and mailed or delivered to the Deputy Director, Office of Administration, Washington, D.C. 20503.

(d) The Deputy Director may waive the fee if: (1) The cost of collecting the fee exceeds the amount collected; or

(2) The production of the copies at no charge is in the best interest of the government.

(e) A receipt will be furnished on request.

#### § 2504.18 Penalties.

(a) Title 18, U.S.C. Section 1001, Crimes and Criminal Procedures, makes it a criminal offense, subject to a maximum fine of \$10,000 or imprisonment for not more than five years, or both, to knowingly and willfully make or cause to be made any false or fraudulent statements or representation in any matter within the jurisdiction of any agency of the United States. Section (i) (3) of the Privacy Act (5 U.S.C. 552a) makes it a misdemeanor, subject to a maximum fine of \$5,000 to knowingly and willfully request or obtain any record concerning an individual under false pretenses. Sections (i) (1) and (2) or 5 U.S.C. 552a provide penalties for violations by agency employees of the Privacy Act or regulations established thereunder.

[FR Doc. 80-18395 Filed 6-17-80; 8:45 am]

BILLING CODE 3115-01-M

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 217

[Regulation Q; Docket No. R-0308]

#### Interest on Deposits; Temporary Suspension of Early Withdrawal Penalty

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Temporary suspension of the Regulation Q penalty normally imposed upon the withdrawal of funds from time deposits prior to maturity.

**SUMMARY:** The Board of Governors, acting through its Secretary, pursuant to delegated authority, has suspended temporarily the Regulation Q penalty for the withdrawal of time deposits prior to maturity from member banks for depositors affected by severe storms and tornadoes in Hall County, Nebraska.

**EFFECTIVE DATE:** June 4, 1980.

**FOR FURTHER INFORMATION CONTACT:** Daniel L. Rhoads, Attorney, Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202/452-3711).

**SUPPLEMENTARY INFORMATION:** On June 4, 1980, pursuant to section 301 of the Disaster Relief Act of 1974 (42 U.S.C. § 5141) and Executive Order 12148 of July 15, 1979, the President, acting through the Director of the Federal Emergency Management Agency, designated Hall County Nebraska, a major disaster area. The Board regards the President's action as recognition by the Federal government that a disaster of major proportions has occurred. The President's designation enables victims of the disaster to qualify for special emergency financial assistance. The Board believes it appropriate to provide an additional measure of assistance to victims by temporarily suspending the Regulation Q early withdrawal penalty.<sup>1</sup>

<sup>1</sup> Effective July 1, 1979, section 217.4(d) of Regulation Q provides that where a time deposit with an original maturity of one year or less, or any portion thereof, is paid before maturity, a depositor shall forfeit at least three months of interest on the amount withdrawn at the rate being paid on the deposit. Time deposits with original maturities of greater than one year require the forfeiture of at least six months' interest when paid prior to maturity. With respect to time deposits issued prior to July 1, 1979, where such deposits, or any portion thereof, are paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed the current ceiling rate for a savings deposit under section 217.7 and the depositor shall forfeit three months of interest payable at such rate. Effective August 1, 1979, a member bank may apply the new, generally less restrictive, penalty to time deposits issued prior to July 1, 1979, with the consent of the depositor. For time deposits entered into, renewed, or extended on or after June 2, 1980,

The Board's action permits a member bank, wherever located, to pay a time deposit before maturity without imposing this penalty upon a showing that the depositor has suffered property or other financial loss in the disaster area as a result of the severe storms and tornadoes beginning June 3, 1980. A member bank should obtain from a depositor seeking to withdraw a time deposit pursuant to this action a signed statement describing fully the disaster-related loss. This statement should be approved and certified by an officer of the bank. This action will be retroactive to June 4, 1980, and will remain in effect until 12 midnight December 6, 1980.

Section 19(j) of the Federal Reserve Act (12 U.S.C. § 371b) provides that no member bank shall pay any time deposit before maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Board. The Board has determined it to be in the overriding public interest to suspend the penalty provision in section 217.4(d) of Regulation Q for the benefit of depositors suffering disaster-related losses within Hall County, Nebraska, which has been officially designated a major disaster area by the President. The Board, in granting this temporary suspension, encourages member banks to permit penalty-free withdrawal before maturity of time deposits for depositors who have suffered disaster-related losses within the designated disaster area.

In view of the urgent need to provide immediate assistance to relieve the financial hardship being suffered by persons in Hall County, Nebraska, directly affected by the severe damage and destruction occasioned by the severe storms and tornadoes, good cause exists for dispensing with notice and public participation referred to in section 553(b) of Title 5 of the United

States Code, the minimum early withdrawal penalty for time deposits with an original maturity of one year or less is a forfeiture of an amount equal to three months of interest earned, or that could have been earned, on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit. For early withdrawals from time deposits with original maturities of more than one year, the minimum penalty shall be a forfeiture of an amount equal to six months of interest earned, or that could have been earned, on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit. For time deposits with original maturities of less than three months, the minimum early withdrawal penalty is forfeiture of an amount equal to the amount of interest that could have been earned on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit had the funds remained on deposit until maturity. Banks may, with the depositor's consent, calculate the early withdrawal penalty for time deposits existing prior to June 2, 1980, on the basis of the nominal simple rate of interest paid on such deposits.

States Code with respect to this action and public procedure with regard to this action would be contrary to the public interest. Because of the need to provide assistance as soon as possible and because the Board's action relieves a restriction, there is good cause to make the action effective immediately.

By order of the Board of Governors, acting through its Secretary, pursuant to delegated authority (12 CFR 265.2(a)(18)), June 12, 1980.

Griffith L. Garwood,

Deputy Secretary of the Board.

[FR Doc. 80-18330 Filed 6-17-80; 8:45 am]

BILLING CODE 6210-01-M

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 240

[Release No. 34-16888]

### Off-Board Trading Restrictions

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Commission announces the adoption of a rule which amends the rules of national securities exchanges which limit or condition the ability of members of those exchanges to effect transactions otherwise than on an exchange in securities which are traded on those exchanges. The adopted rule will prevent those exchange rules from applying to certain securities which were not traded on an exchange on April 26, 1979, or which were traded on an exchange on April 26, 1979, but fail to remain traded on an exchange for any period of time thereafter. In conjunction with the adoption of this rule, the Commission also announces implementation of a program to monitor the operation and effects of the rule and its intention to publish periodic reports of the findings of such a monitoring program in order to provide an empirical basis for public comment on the advisability of further regulatory action.

**EFFECTIVE DATE:** July 18, 1980.

**FOR FURTHER INFORMATION CONTACT:** Bruce Beatt (202-272-2888), Room 390, Division of Market Regulation, or Roger W. Marshall (202-523-5612), Directorate of Economic and Policy Analysis, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission today announced the adoption of Rule 19c-3 ("Rule")<sup>1</sup> under the Securities

Exchange Act of 1934 ("Act"),<sup>2</sup> which amends existing rules of national securities exchanges ("exchanges") which limit or condition the ability of members of those exchanges to effect transactions otherwise than on an exchange in securities which are listed or admitted to unlisted trading privileges on those exchanges ("off-board trading restrictions"). Specifically, Rule 19c-3 will preclude off-board trading restrictions from applying, with certain exceptions, to any reported security<sup>3</sup> (1) which was not traded on an exchange on April 26, 1979, or (2) which was traded on an exchange on April 26, 1979, but which ceases to be traded on an exchange for any period of time thereafter.

In view of the adoption of Rule 19c-3, the Commission does not expect to take further action in the near future with respect to off-board trading restrictions generally. Accordingly, the Commission has also determined to withdraw an earlier Commission proposal still outstanding with respect to off-board trading rules, proposed Rule 19c-2 under the Act.<sup>4</sup> That proposal, which was published in June 1977, would have eliminated all remaining exchange restrictions on (1) off-board principal transactions and (2) "in-house agency crosses," i.e., off-board agency transactions in which a member acts as agent for both buyer and seller in the same transaction, with respect to reported securities.<sup>5</sup> The Commission has determined not to withdraw the alternative overreaching rules, proposed Rules 15c5-1[A], 15c5-1[B], 15c5-1[C] and 15c5-1[D], published in connection with proposed Rule 19c-2.<sup>6</sup>

<sup>1</sup> 15 U.S.C. 78a et seq., as amended by the Securities Acts Amendments of 1975 ("1975 Amendments"), Pub. L. No. 94-29 (June 4, 1975), 89 Stat. 97, (1975) U.S. Code Cong. & Ad. News 97.

<sup>2</sup> The Rule defines the term "reported security" to mean "any security or class of securities for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan." Rule 19c-3(b)(4). Transaction reports and last sale data for reported securities are reported in the consolidated transaction reporting system ("consolidated system") contemplated by Rule 11Aa3-1 under the Act (17 CFR 240.11Aa3-1).

<sup>3</sup> See Securities Exchange Act Release No. 16889 (June 11, 1980).

<sup>4</sup> See Securities Exchange Act Release No. 13662 (June 23, 1977) ("June Release"), 42 FR 33510. In January 1978, the Commission deferred a final decision on Rule 19c-2 pending evaluation of industry and self-regulatory responses to national market system initiatives announced by the Commission. See Securities Exchange Act Release No. 14416 (January 26, 1978), at 38-41, 43 FR 4354, 4359-60. See also Securities Exchange Act Release Nos. 15376 (December 1, 1978) and 15671 (March 22, 1979), 43 FR 58664, 44 FR 20360.

<sup>5</sup> As noted *infra*, adoption of one or more of those alternative proposals may prove necessary to counter adverse consequences of Rule 19c-3 or otherwise in furtherance of the purposes of the Act. See notes 54 and 89, *infra*.

Rule 19c-3 will become effective thirty days following publication of this release in the Federal Register. Because of the significance of concerns raised in connection with the Rule, the Commission expects the self-regulatory organizations, particularly the National Association of Securities Dealers, Inc. ("NASD"), to scrutinize closely the behavior of market participants in securities subject to the Rule. In addition, the Commission itself intends to conduct a comprehensive monitoring program with respect to the operation of the Rule and to issue periodic reports describing the results of that program.<sup>7</sup> Further, and in addition to its periodic review of the impact of Rule 19c-3, the Commission expects to reexamine the issues associated with Rule 19c-3 and exchange off-board trading restrictions generally, to the extent and at such times as appears appropriate in the light of developments in the markets.

### I. Introduction

On April 26, 1979, the Commission published a release ("Release") announcing the instant proceeding, including public hearings, to consider rulemaking to amend off-board trading restrictions.<sup>8</sup> In the Release, the Commission proposed for comment Rule 19c-3, which would prevent off-board trading restrictions from applying to any equity security or class of equity securities, or alternatively, to any reported security,<sup>9</sup> (1) which was not traded on an exchange on April 26, 1979,<sup>10</sup> or (2) which was traded on an exchange on April 26, 1979, but which ceases to be traded on any exchange for any period of time thereafter ("Rule 19c-3 Securities").

In the Release, the Commission reiterated the conclusion it had reached in prior proceedings<sup>11</sup> that off-board trading restrictions impose burdens on competition. In addition, the

<sup>7</sup> For a complete description of the scope and content of the Commission's monitoring program, see text accompanying notes 82-83, *infra*.

<sup>8</sup> See Securities Exchange Act Release No. 15769 (April 26, 1979), 44 FR 26688. In the Release, the Commission reviewed prior Commission action concerning off-board trading restrictions and the concerns which led the Commission to initiate a proceeding. See *id.* at 5-8, 44 FR at 26688-89.

<sup>9</sup> For a discussion of the Commission's determination to limit the scope of the Rule to reported securities, see text accompanying notes 73-76 *infra*.

<sup>10</sup> The Commission specifically requested comment on the propriety of making the Rule applicable as of the date of the proposal of the Rule. See Release *supra* note 8, at 3 n.2, 44 FR at 26688 n.2. However, the Commission did not receive any comment in response to this request.

<sup>11</sup> See Securities Exchange Act Release No. 11942 (December 19, 1975) ("December Release"), at 5-7, 41 FR 4507, 4509; June Release, *supra* note 5, at 30-38, 42 FR at 33514.

<sup>1</sup> 17 CFR 240.19c-3.

Commission indicated its belief that, although it had not yet completed its deliberations with respect to whether the anticompetitive effects of remaining off-board trading restrictions as a general matter are outweighed by the purposes served by those restrictions, it was concerned that, as a consequence of new listings, off-board trading restrictions were continuously being extended to an ever-increasing number of securities (most of which were traded exclusively in the over-the-counter market), thereby precluding the possibility of competition between the over-the-counter market and exchange markets. The proposal of the Rule was therefore designed to preserve existing competition and maintain the status quo regarding the effects of off-board trading restrictions pending a final determination with respect to off-board trading restrictions generally, as contemplated by proposed Rule 19c-2.

In announcing its proposal of the Rule, the Commission took care to distinguish the potential impact of the adoption of Rule 19c-3 from that of proposed Rule 19c-2. In particular, the Commission observed that Rule 19c-3 would apply primarily to securities for which there was a pre-existing over-the-counter market; since a significant percentage of the over-the-counter market making activity in those securities is accounted for by firms which are also exchange members, the effect of listing these securities would be the virtual extinction of this over-the-counter market. In contrast, proposed Rule 19c-2 would have applied primarily to securities which were already traded in an exchange environment and, in part because of the effects of off-board trading restrictions, for which there is currently only an insignificant over-the-counter market. Similarly, the Commission observed that Rule 19c-3, since it would apply to only a limited number of securities, would not appear to have the potential for a significant effect on the existing structure of the securities markets. In contrast, proposed Rule 19c-2, since it would have applied to virtually all exchange traded securities, might possibly have had dramatic and radical effects on those markets.<sup>12</sup>

In addition to limiting the anticompetitive effects of off-board trading restrictions, the Commission indicated its belief that the adoption of the Rule might provide a valuable learning experience to the Commission and the securities industry.<sup>13</sup> The

Commission indicated that adoption of the Rule would permit over-the-counter market makers to experience a trading environment in which transaction and quotation information is made available on a real-time basis. Further, the Commission indicated that the adoption of the Rule would provide the opportunity, in a limited context, to observe the dynamics of a competitive environment between over-the-counter and exchange market makers in exchange traded securities.

In response to the Commission's solicitation of comment on the Rule, the Commission received, and included in the record of the proceeding, written comments from approximately 60 individuals, principally persons associated with the securities industry.<sup>14</sup> The Commission also held six days of oral hearings, beginning June 20, 1979, and concluding July 2, 1979, during which the Commission received testimony from many of the individuals who submitted written comments.

After consideration of the record of the proceeding (which has incorporated the records of prior Commission proceedings)<sup>15</sup> and for the reasons enunciated below, the Commission has determined to adopt Rule 19c-3, effective thirty days following publication of this release in the *Federal Register*.<sup>16</sup>

<sup>14</sup> In the Release, the Commission indicated that, in order to be fair to all interested persons, comments received after July 22, 1979, the final date for submitting comments, would not be accepted as a part of the record of the proceeding or considered by the Commission unless the comment period was formally extended. However, the Commission received a number of comments after July 22, 1979. The Commission thereafter issued a release giving notice that comments on the Rule received after July 22, 1979, would not form part of the official record of the proceeding but would be placed in a separate subfile in which they would be available for public review. See Securities Exchange Act Release No. 16166 (September 7, 1979), 44 FR 54068.

<sup>15</sup> In the Release, the Commission invited the attention of interested persons to materials contained in other Commission files (see File Nos. 4-180, SR-Amex-77-3, SR-Amex-77-18 and S7-735-A), and incorporated the information contained in those files into the record of the proceeding. See Release, *supra* note 8, at 4-5, 44 FR at 26688.

<sup>16</sup> As proposed and adopted, the Rule would be applicable, with certain exceptions, to securities which became or become exchange traded after April 26, 1979. Thus, the Rule would be applicable to certain securities which became exchange traded for the first time after April 26, 1979, the date on which the Rule was proposed for comment, and before the effective date of the Rule, and for which the existing over-the-counter market has therefore been substantially extinguished. However, as discussed below (see text accompanying note 20, *infra*), the purpose of the Rule was not merely to preserve the opportunity for the existing over-the-counter market to compete, but also to maintain the status quo by precluding the expansion of off-board trading restrictions to additional securities. Moreover, the application of the Rule as of April 26, 1979, was designed to avoid any artificial timing

## II. Discussion

### A. Benefits Resulting from Adoption of the Rule

As the Commission has found in its earlier proceedings,<sup>17</sup> off-board trading restrictions have anticompetitive effects, in that they effectively confine trading in listed securities to exchange markets by precluding exchange members from trading as principal in the over-the-counter market. Having reached that conclusion, the Commission must determine whether the continued expansion of these anticompetitive effects can be justified by the purposes of the Act or whether the potential benefits to be achieved by adoption of this limited proposal are outweighed by the possibility of adverse consequences. In reaching its findings, the Commission has noted a number of possible benefits which might be derived from adoption of this limited proposal.<sup>18</sup> First, adoption of the Rule will provide the opportunity for competition between the over-the-counter and exchange markets with concomitant benefits to investors. For example, the presence of additional (and, in some cases, highly capitalized) market makers may (1) operate to discipline the quotations of primary market specialists, thereby possibly resulting in narrower quotation spreads in Rule 19c-3 Securities, and (2) create incentives for markets to disseminate quotations of greater size and add to the depth, liquidity and continuity of the markets for those securities.

The adoption of Rule 19c-3 may also result in cost savings for brokers, dealers and investors in connection with transactions in Rule 19c-3 Securities. The ability of exchange members to effect transactions in-house may provide them with certain execution and operational efficiencies by (1) reducing the order-handling workload of their floor personnel on the exchange floors and the use of other facilities of exchanges, and (2) reducing errors and the costs associated therewith. Moreover, the presence of alternative markets may provide an incentive for markets to continue to compete aggressively in the types and costs of services offered to brokers and investors.<sup>19</sup>

incentives to listing based solely on the possible adoption of the Rule.

<sup>17</sup> See note 11, *supra*.

<sup>18</sup> A discussion of the possible adverse consequences of adoption is contained in the text accompanying notes 31-81, *infra*.

<sup>19</sup> Indeed, competition would appear to have had a substantial role in the development of recent order routing and execution innovations by both the regional and primary exchanges. For example, the American Stock Exchange, Inc. ("Amex") and New

Footnotes continued on next page

<sup>12</sup> See text accompanying notes 21-30, *infra*.

<sup>13</sup> See Release, *supra* note 8, at 14-15, 44 FR at 26690.

In addition, adoption of the Rule will limit the expansion of the anticompetitive effects of off-board trading restrictions which, absent Commission action, would otherwise apply over time to ever-increasing numbers of securities. Thus, the Commission perceives benefits from Rule 19c-3 as a regulatory measure designed to maintain the status quo pending resolution of the broader issues associated with removal of off-board trading rules generally.<sup>20</sup>

The Commission also believes that the Rule is justified by its experimental value which will further the purposes of the Act by providing actual experience with the effects of concurrent over-the-counter and exchange trading. While adoption of the Rule could not be expected to yield empirical data sufficient to support definitive conclusions regarding the removal of remaining off-board trading restrictions,<sup>21</sup> the Commission does believe that experience under the Rule

will yield data which will enable the Commission to analyze the direct effects of the Rule on the trading markets for Rule 19c-3 Securities. In addition, experience under the Rule may prove useful in providing an opportunity to observe for the first time a trading environment in which exchange members may engage in competitive over-the-counter trading in securities which are listed on the primary exchange. In particular, the Rule may provide insight into the ability of exchanges to continue to compete for order flow in the absence of off-board trading restrictions and may provide insight into whether the absence of off-board trading restrictions has any significant effects on pricing efficiency.<sup>22</sup>

In addition, since the Rule will provide the securities industry with an opportunity to experience an environment involving competitive over-the-counter and exchange trading, it may be helpful in evaluating the effectiveness of current efforts to facilitate the development of a national market system. Among other matters, experience under the Rule should enable the Commission to observe the effectiveness of existing systems, particularly the Intermarket Trading System ("ITS")<sup>23</sup> and the Cincinnati Stock Exchange's ("CSE") automated National Securities Trading System ("NSTS"),<sup>24</sup> in addressing the needs of an environment characterized by concurrent exchange and over-the-counter trading, and may provide incentives to improve those systems or develop new systems to accommodate any changes in trading patterns which occur.<sup>25</sup>

In this regard, the Commission views as a significant step in that direction the determination by the NASD to upgrade

and enhance its NASDAQ system to provide a more efficient mechanism for over-the-counter market making in listed securities. The NASD's commitment to such an effort was an important consideration in the Commission's determination to adopt Rule 19-3 at this time.

The Commission believes that prompt implementation by the NASD of the enhanced NASDAQ system will further significantly the objectives of a national market system. The Commission urges the NASD to accelerate its efforts to achieve the NASDAQ system upgrade and requests the NASD to provide the Commission with a formal status report on the project (including a timetable for implementation) not later than September 1, 1980.

Of equal importance is the need to achieve effective linkages between traditional exchange trading floors and markets conducted either over-the-counter or through electronic trading systems. Such linkages, in the Commission's view, are essential to achieving the maximum degree of order interaction between the various types of markets.<sup>26</sup> The Commission therefore expects that the NASD and the ITS participants will promptly conclude their negotiations and begin work on consummating an automated linkage between the ITS and the NASDAQ system. The Commission also expects that the NSTS and ITS participants will implement a linkage between their systems in the near future.<sup>27</sup> The Commission requests the interested parties to these proposed linkages to provide the Commission with formal status reports (including timetables for implementation) on the ITS-NASDAQ and ITS-NSTS linkages not later than September 1, 1980.<sup>28</sup>

Observation of trading in an environment free of off-board trading restrictions may also enable the Commission to consider the appropriateness of existing Commission and exchange rules which apply to exchange specialists and provide insight regarding whether some or all of the requirements and principles embodied in those rules should be extended to over-the-counter market makers in order

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York Stock Exchange, Inc. ("NYSE") have developed a "common message switch," which provides an interface between the computerized order handling systems of certain Amex and NYSE firms and the booths of those firms on the floors of the Amex and NYSE. In addition, the Amex and NYSE offer automated order routing systems (named Post Execution Report ("PER") and Designated Order Turnaround System ("DOT"), respectively) which permit Amex and NYSE member firms to route small market and limit orders directly to the specialist's post. Further, the Pacific Stock Exchange, Inc. ("PSE") and Philadelphia Stock Exchange, Inc. ("Phlx") provide systems (named "SCOREX" and "PACE," respectively) similar to PER and DOT which, in addition, provide for automatic execution based on a derivative pricing model.

<sup>20</sup> See Securities Exchange Act Release No. 15376 (December 1, 1978), at 18 n. 42 (Commissioners Evans and Pollack dissenting), 44 FR 58664, 58669 n. 42.

<sup>21</sup> Various commentators apparently understood, mistakenly, that the Commission was proposing the Rule as an "experiment" which would yield data from which the Commission could extrapolate in order to reach definitive conclusions regarding the further removal of off-board trading restrictions. These commentators criticized the "experiment" as inherently invalid for a variety of reasons including, for example, the limited number and unrepresentative nature of the securities to which the Rule would be applicable. See, e.g., *In re Off-Board Trading Restrictions*, File No. 4-220 ("Proceeding Transcript"), at 149-50, 212, 273-74, 634-35, 694-95, 777, 1001-02. As indicated, see text accompanying notes 82, 87-89, *infra*, these comments misconstrued the Commission's attitude toward the experimental value of the Rule. The Commission never intended (nor could it have intended) the type of proposal represented by Rule 19c-3 as a scientific experiment designed to resolve fully all of the issues raised by the continuation or removal of off-board trading restrictions as a general matter. Nonetheless, the Commission believes that useful data can be derived from observation of the trading environment in Rule 19c-3 Securities both before and after the effective date of the Rule, and that it will be able to study the effects of the Rule using statistical evaluation techniques.

<sup>22</sup> Examination of these issues will be part of the Commission's monitoring program. See text accompanying notes 82-83, *infra*.

<sup>23</sup> See Securities Exchange Act Release Nos. 14661 (April 14, 1978), 15058 (August 11, 1978), 16074 (August 2, 1979) and 16214 (September 21, 1979), 43 FR 17419 and 36732, 44 FR 47419 and 56069.

<sup>24</sup> See Securities Exchange Act Release Nos. 14674 (April 18, 1978), 15413 (December 15, 1978) and 16215 (September 21, 1979), 43 FR 17894, 44 FR 129 and 56074.

<sup>25</sup> Indeed, the Commission notes that the proposal of the Rule has been followed by various initiatives applicable to intermarket competition. Thus, the NASD has announced technical enhancements to the NASDAQ system which would provide an order routing facility, the opportunity for automatic execution of orders and a linkage with exchanges. See *Proceeding Transcript*, *supra* note 21, at 9-10, 24-34. In a different approach to intermarket competition, the NYSE has proposed to create facilities which would permit NYSE member firms to enter electronically dealer bids and offers into the NYSE market trading crowd without maintaining a physical presence on the NYSE floor. See *id.* at 779-80, 817-22.

<sup>26</sup> See Securities Exchange Act Release No. 16214, at 14 (September 21, 1979), 44 FR 56069, 56072.

<sup>27</sup> The Commission has stated that "it will be necessary to . . . establish computerized interfaces between the ITS and over-the-counter market makers regulated by the NASD and between the ITS and the CSE System (and such other systems as may emerge in the future) permitting two-way communication." See *id.*

<sup>28</sup> See Letter from Douglas Scarff, Director, Division of Market Regulation, to John J. Phelan, Jr., Vice Chairman, NYSE, dated May 20, 1980.

to ensure "equal regulation."<sup>29</sup> Finally, experience under the Rule may enable the Commission to obtain data with which to monitor the effects of reporting transaction information on the willingness of over-the-counter market makers to engage in market making in securities traded in an integrated trading environment.<sup>30</sup>

#### B. Discussion of Arguments Raised in Opposition to Adoption of the Rule

Balanced against the foregoing benefits, the Commission has carefully considered the criticisms of the Rule raised by commentators and the possible adverse consequences of its adoption.

1. *Internalization.* The most frequent criticism of the Rule was that, if adopted, it would permit "internalization" by broker-dealer firms with large retail order flow or sizable correspondent networks who chose to make markets over-the-counter in Rule 19c-3 Securities ("integrated firms").<sup>31</sup> Some commentators argued that internalization by such firms would have three principal adverse effects. First, internalization would have anticompetitive effects with respect to both exchange specialists (who generally do not have initial access to retail order flow) and smaller broker-dealers without the market making capacity of larger, integrated firms. Second, internalization might result in "fragmented" markets in Rule 19c-3 Securities<sup>32</sup> and lead to a decrease in

pricing efficiency and a deterioration in the depth, liquidity and continuity of the markets for those securities. Finally, internalization might provide an increased opportunity for overreaching of customers, particularly by integrated firms.<sup>33</sup>

(a) *Fragmentation and Competitive Impact.* (i) *Comments.* With respect to the perceived anticompetitive effects of internalization, various commentators asserted that large integrated firms would find it in their economic self-interest to execute their retail order flow "in-house," and that, as a result, specialists and other market makers would not have the opportunity to compete for that order flow. It was therefore argued that the only way to rectify this competitive disadvantage was to require integrated firms, through intermarket linkage systems, to "expose" their retail order flow to other competing market makers.<sup>34</sup> Commentators also asserted that the opportunity to internalize retail order flow would place smaller broker-dealers at a competitive disadvantage because they would no longer be able to provide executions equivalent to those provided by larger integrated firms.<sup>35</sup> It was argued that, in the current environment, in which off-board trading restrictions result in most retail firms directing their order flow as agent to either the Amex or NYSE, all retail broker-dealers (regardless of size) are able to provide the same quality of execution because each may provide retail customer orders with an equal opportunity to be exposed to the vast majority of order flow in listed securities. However, in the absence of off-board restrictions, the Amex and NYSE might no longer attract sufficient order flow to be the "primary" markets for Rule 19c-3 Securities. In that event, smaller broker-dealers would no longer be able to compete effectively with large integrated firms on the basis of quality of execution because, it was argued, the public would perceive that larger firms would provide better executions and would therefore direct most order flow to those firms. In addition, it was argued that larger firms would have a competitive advantage

since they would more effectively be able to integrate market making and retail business in order to provide lower cost executions than could be provided by smaller firms. This might further the public perception that, in order to obtain a quality execution, they should deal directly with firms which are market makers rather than with firms which provide only brokerage services.<sup>36</sup>

Other commentators argued that internalization was perfectly appropriate if conducted on the basis of "quote matching," i.e., providing an execution in one market center at a price equal to the best price displayed in the consolidated quotation system.<sup>37</sup> Those commentators argued that retention of order flow by a market center did not raise competitive concerns if there is no overreaching<sup>38</sup> and the customer is given a price which is equal to or better than the best price available in any other market (as evidenced by the best quotation then disseminated pursuant to Rule 11Ac1-1 under the Act).<sup>39</sup>

With respect to the concern that internalization would result in additional fragmentation which would adversely affect market efficiency and liquidity, commentators asserted<sup>40</sup> that, as a result of the internalization of retail firm customers' orders, order flow in

<sup>36</sup> Other commentators, however, argued that those firms which chose to make markets upstairs would be under a competitive disadvantage. (*Id.*, at 21-22, 58-60, 424-26). Those commentators contended that, at least with respect to those firms which did not have adequate in-house order flow to support their market making activities, the existence of automated order routing systems permitting most broker-dealers to efficiently send orders to exchanges (*see note 19, supra*) and the absence of similar systems for routing orders to over-the-counter market makers would provide competitive advantages to specialists (particularly specialists in the "primary" market). However, even if order routing systems currently provide a competitive advantage to "primary" exchange specialists, it may be questioned whether in an environment permitting off-board principal trading, these order routing systems would continue to provide a competitive advantage to exchange specialists since it is unclear whether retail firms would avail themselves of such systems to route orders to specialists (as opposed to executing those orders "in-house"). In this connection, the Commission understands that currently retail firms competing as market makers in securities traded solely in the over-the-counter market generally do not route to other market makers who quote a better quotation but instead match that better quotation and retain the retail execution.

<sup>37</sup> *See, e.g.,* Proceeding Transcript, *supra* note 21, at 728.

<sup>38</sup> *See note 33, supra.*

<sup>39</sup> Rule 11Ac1-1 (17 CFR 240.11Ac1-1) requires every exchange and national securities association to establish and maintain procedures to collect, process and make available to vendors quotations (including size) in reported securities. *See Securities Exchange Act Release No. 14415* (January 26, 1978), 43 FR 4342.

<sup>40</sup> Proceeding Transcript, *supra* note 21, at 222-24, 220-300, 630, 684-91, 775-76, 791-98, 998-1001.

<sup>29</sup> *See text accompanying notes 63-72, infra.*

<sup>30</sup> *See also* proposed Rule 11Aa2-1 which, if adopted, would provide procedures by which securities would be designated as national market system securities. *See Securities Exchange Act Release No. 15920* (June 15, 1979), 44 FR 26912. That rule, together with related amendments to Rule 11Aa3-1, would require a limited number of actively traded securities traded solely in the over-the-counter market to be subject to transaction reporting. Rule 19c-3 and proposed Rule 11Aa2-1 are related proposals which may enable the Commission to consider the concern raised by over-the-counter market makers that transaction reporting would discourage over-the-counter market making activities because of the increased risks and pressures on spreads which might result from disclosure of transaction information.

<sup>31</sup> In the Release, the Commission stated that the term "internalization," when used with respect to the activities of an integrated broker-dealer making markets over-the-counter refers to the withholding of retail orders from other market centers for the purpose of executing them "in-house," as principal, without exposing those orders to buying and selling interest in those other market centers.

*See Release, supra* note 8, at 12 n.20, 44 FR at 26690 n.20. *See also* June Release, *supra* note 5, at 49-66, 42 FR at 33516-21.

In general, commentators agreed with this definition of the term. *See, e.g.,* Proceeding Transcript, *supra* note 21, at 774.

<sup>32</sup> In the Release, the Commission stated that the term "fragmentation" refers to the dispersion of order flow among market centers.<sup>33</sup> *See Release,*

*supra* note 8, at 12 n.20, 44 FR at 26690 n.20. *See also* June Release, *supra* note 5, at 49-66, 42 FR at 33516-21.

<sup>33</sup> The term "overreaching" refers to the possibility that broker-dealer firms may take advantage of their customers by executing retail transactions as principal at prices less favorable to those customers than could have been obtained had those firms acted as agent. *See generally* June Release, *supra* note 5, at 70-84, 42 FR at 33519-21.

<sup>34</sup> Proceeding Transcript, *supra* note 21, at 219, 309-14, 630, 653-54, 684-91, 726-29, 732-33, 740-41, 798-803, 830-31, 848-51, 857-60, 871-77, 998-99.

<sup>35</sup> *Id.* at 173, 1053.

Rule 19c-3 Securities no longer would be directed to the Amex and NYSE as "primary" markets, and that, in the absence of intermarket linkages or other types of systems which would permit the effective interaction of orders originating in geographically diverse market centers, such a dispersion of order flow would make the markets in Rule 19c-3 Securities less efficient than currently is the case today in exchange traded securities where one market has a dominant share of order flow.<sup>41</sup> In addition, commentators argued that increased fragmentation might diminish limit order protection and create difficulties for brokers attempting to route their customers' orders to the best available market.

Other commentators, however, did not view fragmentation as a significant problem in connection with the Rule.<sup>42</sup> These commentators argued that fragmentation concerns would be minimized because Rule 19c-3 Securities, upon becoming exchange traded, would be the subject of real-time transaction and firm quotation information which should reduce pricing disparities among market centers and enhance the ability of brokers to find the best markets for their customers' orders. In addition, they anticipated that the development of intermarket linkages would both enhance the protection of limit orders and permit brokers to route orders more easily to another market center displaying a superior quotation.

(ii) *Discussion.* In its prior releases regarding off-board trading restrictions, the Commission has expressed its view that an ideal configuration of a national market system would effectively preclude internalization by exposing orders, to the greatest extent practicable, to all buying and selling interest wherever located in the system. Such a displacement mechanism would permit brokers and dealers, regardless of geographic location, to intercept order flow by bettering existing bid and offer quotations. Specifically, the Commission has indicated that intermarket exposure of orders in a national market system should (1) maximize competition between and among markets and market participants and (2) further the

efficiency and fairness of the securities markets.<sup>43</sup>

While the Commission recognizes that a significant degree of order exposure may be present today in certain securities within the "primary" markets, the Commission also recognizes that most trading in listed securities is conducted in a manner which does not result in routine exposure of order flow to other competing market centers.<sup>44</sup> To the contrary, internalization (*i.e.*, failure to expose orders to potential buying and selling interest in other markets) is present in the trading of listed securities on exchanges as well as the over-the-counter market. For example, orders sent to regional exchanges or the third market are often executed in those markets without any intermarket exposure, either because they are executed there as a result of previously negotiated price protection against transactions in the "primary" market or because they are executed, on an automated basis,<sup>45</sup> based on a derivative pricing formula. Moreover, the development of systems such as the ITS<sup>46</sup> and the NSTS<sup>47</sup> has not significantly ameliorated this situation.<sup>48</sup>

Similarly, despite the implementation of ITS, orders sent to the primary market will not necessarily be exposed to trading interest represented in other markets even when there is a better published quotation in another market. First, a specialist or other broker-dealer on the floor of the primary market may choose to match a better bid or offer displayed by a regional exchange and execute an order himself rather than send a commitment to the other

participant through ITS. As a result, ITS may serve only to encourage price matching rather than intermarket order exposure. Further, use of the ITS, while encouraged by the ITS participants, is not mandatory when a better bid or offer is available from an ITS participant. Finally, a linkage has not yet been established between the ITS and the over-the-counter market and between the ITS and the NSTS.<sup>49</sup>

The Commission recognizes that the adoption of Rule 19c-3 may result in internalization by member firms, particularly those firms with large retail order flow. While the Commission is concerned about increasing the opportunity for internalization, it has nevertheless on balance decided to adopt the Rule, given its limited scope. First, the problems resulting from internalization are generic in nature. Rather than deprive the securities markets of an opportunity to benefit from increased market maker competition, the Commission believes that the Rule should be put into effect and that any adverse effects which may result from internalization should be dealt with directly through other measures. For example, the Commission could require that all trading by integrated firms occurring otherwise than on a physical exchange trading floor be conducted through a trading system which provides an opportunity for interaction of order flow and exposure to other over-the-counter and exchange market makers. In addition, it may be necessary to go further and require integrated firms to "hold out" agency retail orders to other buying and selling interest for a minimum period of time prior to executing against that order as principal.<sup>50</sup> Finally, it may be necessary to consider prohibiting firms from acting in both a broker and dealer capacity (either over-the-counter or both over-the-counter and on exchange floors) in the same security.<sup>51</sup>

In addition, the risks relating to internalization in the context of adoption of the Rule do not appear to raise concerns of the magnitude raised with respect to proposed Rule 19c-2. An overriding concern raised by commentators was that the adoption of Rule 19c-2 would result in substantial losses in order flow to the primary exchanges in a large number of securities which might ultimately lead to

<sup>41</sup> See December Release, *supra* note 11, at 48-49, 41 FR at 4519; June Release, *supra* note 5, at 57-60, 42 FR at 33517.

<sup>42</sup> See June Release, *supra* note 5, at 57-58, 42 FR at 33517.

<sup>43</sup> Thus, in the PSE's SCOREX system, member firm market orders of up to 300 shares in approximately 200 Amex and 800 NYSE listed securities are automatically priced and executed based on the best quotation disseminated by a participant in the ITS. Similarly, in the Phlx's PACE system, member firm market orders of up to 399 shares in approximately 300 NYSE listed securities are automatically priced and executed based on the better of the quotations available in the Phlx and NYSE markets (*see* note 19, *supra*). As a result of the operation of SCOREX and PACE, certain market orders sent to the PSE and Phlx do not interact with each other and are effectively precluded from interacting with orders in other markets.

<sup>44</sup> As discussed below, ITS is not generally used to expose orders to other markets. *See* text accompanying note 49, *infra*.

<sup>45</sup> Although NSTS terminals are present on certain regional exchanges, the System has not been used with any frequency by brokers and dealers in those markets.

<sup>46</sup> As discussed below, the NSTS and ITS are not currently linked to third market makers, thereby precluding intermarket exposure. *See* text accompanying note 49, *infra*.

<sup>47</sup> *See* text accompanying notes 26-28, *supra*.

<sup>48</sup> Systems like the NSTS or the enhanced NASDAQ System, if appropriately linked to conventional exchange markets through the ITS, could be employed for this purpose.

<sup>49</sup> *Cf.* Securities Exchange Act Release No. 16214, at 10 n.18 (September 21, 1979, 44 FR 56069, 56071 n.18).

<sup>41</sup> For example, commentators suggested that prices in a fragmented market will be less likely to reflect a complete assessment of all buying and selling interest than is presently possible. In addition, they suggested that directing most order flow to the "primary" markets provides the opportunity for orders to be executed at a price between the current best bid and offer quotations.

<sup>42</sup> Proceeding Transcript, *supra* note 21, at 43-44, 407-08.

the demise of exchanges. In contrast, whatever the effects of internalization in the context of Rule 19c-3, those effects, which would be applicable only to a relatively limited number of securities, do not appear to have the potential to reduce the total amount of trading occurring on exchanges to the point where the existence of these trading mechanisms would be undermined. Similarly, the limited scope of Rule 19c-3 would seem to indicate that adoption of the Rule should not significantly impact the existence, as viable competitors, of smaller broker-dealers. Moreover, as noted above, should internalization prove to have significant adverse effects in the context of Rule 19c-3, those effects can be eliminated at any time.

Finally, the Commission believes that the Rule presents the Commission with a unique opportunity to consider <sup>52</sup> concerns relating to the effects of internalization in a limited context. First, adoption of the Rule may provide the Commission and industry with an opportunity to learn the extent to which retail firms will determine to make over-the-counter markets in reported securities and the degree to which these firms will internalize their own retail order flow. In addition, the Rule might enable the securities industry to experiment with systems which would provide an opportunity for greater interaction of exchange and over-the-counter markets, thereby eliminating most of the potential adverse effects of this practice.<sup>53</sup>

Notwithstanding the Commission's decision to adopt the Rule, the Commission recognizes that internalization raises significant regulatory concerns. Therefore, as part of its monitoring program, the Commission intends to examine closely the markets in Rule 19c-3 Securities to determine the extent to which internalization develops and its effects on the securities markets. In addition, the Commission expects the NASD to oversee carefully the activities of integrated firms in this trading environment and to provide the Commission with quarterly reports

(beginning September 30, 1980) of the results of its oversight program. The Commission will be alert to the need to take appropriate regulatory action if any internalization which may occur has undesirable effects on the markets for Rule 19c-3 Securities.

(b) *Overreaching and Surveillance.*  
(i) *Comments.* In general, commentators in the current proceeding did not focus substantial attention on overreaching and the adequacy of surveillance to detect overreaching and other questionable trading activity by integrated firms.<sup>54</sup> The NASD strongly disagreed with suggestions by certain commentators <sup>55</sup> that its surveillance would be inferior to that provided by exchanges and indicated that, in response to the proposal of the Rule, it was developing appropriate enhancements to existing regulatory and surveillance programs.<sup>56</sup> Among other matters, the NASD indicated that it would provide sufficient surveillance and inspection personnel to ensure that over-the-counter market makers are meeting their responsibilities with respect to the prompt reporting of trades in the consolidated system.<sup>57</sup>

<sup>54</sup> In the proceeding relating to proposed Rule 19c-2, the Commission indicated its concerns regarding overreaching and the adequacy of surveillance, and proposed four alternative overreaching rules to deal with overreaching concerns. See *id.* The Commission wishes to point out that, although the Commission has determined to withdraw proposed Rule 19c-2, the alternative overreaching rules published in connection with proposed Rule 19c-2 are still outstanding and that the Commission may, in response to trading activities and patterns which develop in Rule 19c-3 Securities, adopt one or more of those alternative rules if necessary or appropriate to counter adverse consequences of Rule 19c-3 or otherwise in furtherance of the purposes of the Act. For the text and a description of these proposals, see June Release, *supra* note 5, at 111-46, 42 FR at 33525-29.

<sup>55</sup> See, e.g., Proceeding Transcript, *supra* note 21, at 999-1003.

<sup>56</sup> *Id.* at 17-18.

<sup>57</sup> The Commission, in proposing Rule 19c-2, had indicated that reporting of transaction information in the consolidated system and dissemination of firm quotation information pursuant to then proposed Rule 11Ac1-1 should reduce the risks of overreaching. However, various commentators discounted the significance of reporting of transaction information to ameliorate this concern. First, commentators suggested that the usefulness of transaction information as a surveillance or informational tool would be drastically reduced because integrated firms would generally fail to report transactions promptly and that as a result trades executed in various markets would be reported out-of-sequence on the consolidated tape. Commentators asserted that on a primary exchange prompt reporting was ensured by the use of reporters to collect transaction information and the presence of a crowd to discipline the behavior of floor members, while, in contrast, trades executed in the over-the-counter market are reported from brokers' offices without any crowd or equivalent discipline. Second, commentators suggested that trades reported in the over-the-counter market could not be compared with trades reported on an

(ii) *Discussion.* Notwithstanding the absence of substantial comment, the Commission continues to believe that conflicts of interest inherent in integrated firms present significant concerns with respect to overreaching. The Commission believes that to some extent these concerns will be ameliorated by the existence of accurate transaction reporting and quotation information, particularly in view of the NASD's recent rule filing designed to ensure that, to the greatest extent practicable, over-the-counter transactions in reported securities are reported in a manner substantially comparable to exchange transactions in such securities.<sup>58</sup> Moreover, as the Commission has noted on prior occasions,<sup>59</sup> when an integrated firm functions as dealer with a retail customer and, by a course of conduct, has placed itself in a position of trust and confidence with respect to that customer, the firm has assumed a fiduciary relationship in all of its securities transactions with that customer, regardless of whether the firm is acting as a broker or dealer in particular transactions.<sup>60</sup> The Commission believes that the existence of this fiduciary relationship should, as a legal matter, reduce the risks of overreaching in connection with over-the-counter trading by integrated firms in Rule 19c-3 Securities.

exchange in order to surveil for possible overreaching or other regulatory concerns because, while trades effected on an exchange are reported on a "gross" basis (i.e., exclusive of any commission which may be charged to the actual customer in connection with a transaction), trades effected over-the-counter (other than with respect to so-called "riskless principal transactions"), are reported to include any retail mark-up or mark-down, which may be deemed equivalent to a commission. These concerns are responded to below.

<sup>58</sup> The NASD has recently filed amendments to its rules which contemplate requiring the reporting of over-the-counter transactions on a "gross" basis. See Securities Exchange Act Release No. 16686 (March 21, 1980), 45 FR 20604. Specifically, the NASD proposal contemplates that transactions will be reported exclusive of any mark-up or mark-down.

<sup>59</sup> See, e.g., June Release, *supra* note 5, at 77-80, 42 FR at 33520.

<sup>60</sup> See Arleen W. Hughes, 27 SEC 629 (1948), *aff'd sub nom. Arleen W. Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949). For a discussion of the standards of conduct applicable to a firm in a fiduciary relationship with a customer, see June Release, *supra* note 5, at 79-82, 42 FR at 33520-21. The fiduciary obligation duties, which may arise out of a broker-customer relationship as well as a dealer-customer relationship, are in addition to the general duty of all dealers, under the so-called "shingle theory," to deal fairly with the public and to effect transactions as dealer with customers at prices reasonably related to the current market for such securities. See Charles Hughes & Co., 13 SEC 676 (1943), *aff'd sub nom. Charles Hughes v. SEC*, 139 F.2d 434 (2d Cir.), *cert. denied*, 321 U.S. 786 (1944); Duker & Duker, 6 SEC 386 (1939).

<sup>52</sup> See text accompanying notes 21-22, *supra*.

<sup>53</sup> For example, integrated firms may wish to consider voluntarily entering their order flow in Rule 19c-3 Securities in the NTS. In addition, the CSE may wish to consider the addition of a "hold-out" requirement to its rules applicable to the NTS. Similarly, in response to the NASDAQ system, integrated firms may wish to consider trading Rule 19c-3 Securities through the NASDAQ system. Further, the NYSE may wish to implement its proposal to create facilities which would permit NYSE member firms to electronically enter dealer bids and offers into the NYSE market trading crowd.

The Commission remains concerned, however, that, in an off-board trading environment, the potential for overreaching may still exist. Therefore, in light of the substantial harm to investors if overreaching were to occur, the Commission expects the NASD to conduct a rigorous monitoring and enforcement effort, including evaluation of individual over-the-counter transactions in Rule 19c-3 Securities, taking into account (1) the net transaction price to customers; (2) the amount of mark-up or mark-down; (3) the price reported to the consolidated system; and (4) the price obtainable if the customer's order were executed on an agency basis in another market. The Commission requests the NASD to provide quarterly reports (beginning September 30, 1980) regarding NASD member compliance with the Act and NASD rules in connection with trading in Rule 19c-3 Securities.<sup>61</sup> The Commission will evaluate carefully the results of the NASD's surveillance programs in order to determine whether additional regulatory action is necessary, such as adoption of any of the four overreaching rules proposed in 1977 in connection with the proposal of Rule 19c-2.<sup>62</sup>

**2. Equal Regulation.** a. *Comments.* In the Release, the Commission specifically requested comment on whether, as a prerequisite to adoption of the Rule, "any Commission or self-regulatory rules regulating the activities of market makers should be eliminated or modified or whether they should be expanded to apply to all market participants performing similar functions."<sup>63</sup> The issue of "equal regulation" raises the question whether a trading environment characterized by the absence of offboard trading restrictions would, in the absence of uniform (or at least similar) regulation of all market makers, afford a fair field of competition among market makers.<sup>64</sup>

Certain commentators criticized the proposal because it was not accompanied by additional regulatory action to ensure similar regulation between exchange specialists and over-

the-counter market makers.<sup>65</sup> These commentators argued that the absence of similar regulation of specialists and over-the-counter market makers trading in Rule 19c-3 Securities would place specialists at an unfair competitive disadvantage. Thus, they urged the Commission to require that various Commission and exchange rules applicable to specialists, particularly primary market specialists, be made applicable to over-the-counter market makers.

Other commentators did not perceive the need for additional regulation of over-the-counter market makers in connection with the adoption of the Rule.<sup>66</sup> These commentators argued that, until experience was obtained under the Rule, it would not be possible to determine the extent to which Commission or self-regulatory rules should be applied to all market makers. In addition, commentators argued that the obligations imposed on primary exchange specialists involved exchange decisions which reflected competitive considerations. In this connection, they noted that those obligations are required because of specialists' virtual monopoly position, and that those obligations are a competitive advantage to specialists since, by advertising the quality of regulation applicable to the exchange market, they assist in attracting order flow.

b. *Discussion.* The Commission has long recognized that removal of off-board principal restrictions in any context requires the Commission to consider certain "equal regulation" concerns.<sup>67</sup> However, the Commission does not view the concept of "equal regulation" as necessarily requiring uniform regulation of all market makers.<sup>68</sup> Rather, uniform regulation is appropriate only when applied in the context of persons who enjoy similar privileges, perform similar functions and have the potential for similar market impact. Moreover, the Commission believes that the differences between regulation of exchange and over-the-counter market makers have been emphasized without recognizing the

many similarities in that regulation, at least with respect to the trading of listed securities. For example, exchange and over-the-counter market makers are both subject to the Commission's rules, Rules 11Aa3-1 and 11Ac1-1 under the Act,<sup>70</sup> requiring the reporting of transaction and quotation information. In addition, the Commission's short sale rule, Rule 10a-1 under the Act,<sup>71</sup> applies to transactions in reported securities effected both on exchanges and in the over-the-counter market. Furthermore, as discussed above,<sup>72</sup> retail integrated firms, in many instances, in fact occupy a fiduciary position of trust and confidence with their customers.

The Commission has determined not to consider modification of any Commission or exchange rules prior to the adoption of Rule 19c-3. The Commission agrees with those commentators who stated that, until experience was obtained under the Rule, it would be extremely difficult, if not impossible, to determine the extent to which any type of market maker regulation should be universally applied.

Similarly, in view of the limited scope of Rule 19c-3, the Commission is not inclined to approve, prior to implementation of the Rule, any alteration of existing rules of the "primary" exchanges which impose "affirmative" and "negative" obligations upon specialists and which prohibit specialists on such exchanges from accepting orders directly from institutional customers. In view of the unique trading position of the primary market specialist generally (particularly in light of his control of the limit order book), retention of such rules appears to be appropriate pending experience under the Rule with concurrent exchange and over-the-counter trading.

The Commission wishes to emphasize that its determination not to require at this time uniform regulation of all market makers trading in Rule 19c-3 Securities should not be construed as a determination that changes in existing regulations governing market making (including the possible imposition of market making obligations on persons making markets over-the-counter in Rule 19c-3 Securities) would not be appropriate in the future either based on the nature of experience under the Rule or developments in the evolution of a national market system. In this connection, the Commission intends to analyze carefully the effects of the absence of uniform regulation on the ability of specialists and over-the-

<sup>61</sup> In addition, if the Commission approves the NASD's proposed reporting rule, it expects that the NASD will monitor the operation of this rule and include in its report an analysis of the accuracy of trade reports communicated pursuant to the rule. As a part of that report, the Commission expects that the NASD will review whether integrated firms are reporting transactions promptly to the consolidated system.

<sup>62</sup> See text accompanying note 6 *supra*; June Release, *supra* note 5, at 111-31, 42 FR at 33525-27.

<sup>63</sup> See Release, *supra* note 8, at 16, 44 FR at 26690.

<sup>64</sup> See June Release *supra* note 5, at 85-90, 42 FR at 33521; December Release, *supra* note 11, at 24-25, 41 FR at 4514.

<sup>65</sup> Proceeding Transcript, *supra* note 21, at 224-26, 629-30, 649-51, 685-88, 724-25, 784-85, 1005-06.

<sup>66</sup> *Id.* at 10, 19-23, 397-403, 418-24.

<sup>67</sup> See December Release, *supra* note 11, at 25-26, 41 FR at 4514; June Release, *supra* note 5, at 85-87, 42 FR at 33521. For a description of Commission and self-regulatory rules regarding market makers, see June Release, *supra* note 5, at 88-90, 42 FR at 22521-22.

<sup>68</sup> See Section 3(a)(36) of the Act, 15 U.S.C. § 78c(a)(36).

<sup>69</sup> See Senate Comm. on Banking, Housing & Urban Affairs, Report to Accompany S-249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 14-16 (1975) reprinted in, [1975] U.S. Code Cong. & Ad. News 179, 182-94.

<sup>70</sup> 17 CFR 240.11Aa3-1 and 240.11Ac1-1.

<sup>71</sup> 17 CFR 240.10a-1.

<sup>72</sup> See text accompanying notes 59-60, *supra*.

counter market makers to compete fairly for order flow in rule 19c-3 Securities. In particular, the Commission will focus on any changes in competitive position of various market participants which may occur as the result of shifts in order flow, the willingness of over-the-counter participants to make markets under varying market and economic conditions and the quality of executions provided by the various markets.

3. *Scope of the Rule. a. Comments.* The Commission proposed the Rule in alternative forms, one of which would be applicable to all equity securities which became exchange traded after April 26, 1979, and one of which would be applicable only to reported securities which became exchange traded after April 26, 1979.<sup>73</sup> As indicated in the Release, adoption of a rule applicable to all equity securities would possibly result in off-board trading in a small number of securities listed on regional exchanges which are not subject to transaction or quotation reporting.<sup>74</sup> The Commission specifically requested comment on whether the absence of transaction information would justify the continuing application of off-board trading restrictions notwithstanding the perceived anticompetitive effects of those rules.

The regional exchanges opposed application of the Rule to equity securities which are not reported securities.<sup>75</sup> They argued that the availability of transaction information with respect to Rule 19c-3 Securities was necessary in order to reduce concerns regarding fragmentation and overreaching and to enable regional exchanges to advertise the existence of their markets as a means of competing with integrated firms for order flow. Other commentators favored the application of the Rule to all equity securities, arguing that the anticompetitive effects of off-board trading restrictions are of greater significance in connection with securities which are not reported securities because those securities are generally thinly traded and therefore would particularly benefit from the additional market making competition which would result from elimination of existing off-board restrictions.<sup>76</sup>

b. *Discussion.* The Commission recognizes that, as indicated by the comments described above, there are reasonable arguments both in favor of and opposing the application of the Rule

to securities which are not reported securities. For several reasons, however, the Commission has determined to limit the scope of the Rule to securities which are reported securities. First, the Commission believes that it should proceed in a manner which minimizes the concerns which have been expressed with respect to effects of the Rule on the markets in Rule 19c-3 Securities. Thus, as noted by commentators, limiting application of the Rule to securities which are reported securities should minimize, to the maximum extent practicable, concerns over fragmentation and overreaching resulting from the absence of current and continuous transaction reporting and the availability of up-to-date quotation information. In addition, application of the Rule to securities which are not reported securities might impede the ability of the Commission and the self-regulatory organizations to conduct surveillance concerning the effects of removal of off-board trading restrictions since reports of transactions effected in the over-the-counter market in such securities would not otherwise be collected and made publicly available.

4. *Effect on Particular Exchanges. a. Comments.* In requesting comment on the competitive implications of the Rule, the Commission noted that the Rule is generally limited to securities currently traded exclusively in the over-the-counter market, and that, as a result, there was a possible competitive concern that specialists on exchanges which derive most of their new listings from other exchanges would be less affected by the Rule than specialists on exchanges which derive most of their new listings from the over-the-counter market.<sup>77</sup> One commentator addressed this issue, arguing that the Rule would have a more adverse competitive impact on the Amex, and its specialists, than other exchanges because of the significant proportion of Amex new listings derived from the over-the-counter market.<sup>78</sup>

b. *Discussion.* While the Commission of course remains concerned over any disproportionate effect its regulatory

action may have on particular exchanges, the Commission does not believe that these concerns, in this limited context, should preclude adoption of the Rule or require a modification of its terms. The Commission notes that recent trends in exchange listings indicate that all exchanges currently receive a large proportion of their listings directly from the over-the-counter market. Further, since all exchanges are ultimately dependent on the over-the-counter market for future growth in terms of new listings, any differing effect on specialists located on different exchanges may only be transitional.

5. *Technical Comments and Amendments. a.* The Commission received comments from the NYSE addressing certain technical aspects of the Rule.<sup>79</sup>

(1) The NYSE recommended that the Rule should be amended to restrict its application to those equity securities which, immediately prior to their first becoming listed and registered on an exchange, have been traded in the over-the-counter market. In this regard, it was argued that such an amendment would be consistent with the primary purpose of the Rule, which the NYSE perceived as the need to preserve "existing" competition between the over-the-counter market and the exchange markets. As discussed above, however,<sup>80</sup> the Rule was designed to maintain the status quo with respect to the application of off-board trading restrictions pending any further action with respect to off-board trading rules generally. In this regard, the Rule is necessary not only to preserve existing competition between the over-the-counter market and the exchange markets but also to preserve the possibility of competition between such markets with respect to a newly-issued security. As a result, the Commission has determined not to confine the Rule to the more limited scope proposed by the NYSE.

(2) The Rule provides that, with certain exceptions, any security which, after April 26, 1979, becomes delisted on an exchange and subsequently becomes exchange traded would no longer be a "covered security" and that, therefore, off-board trading restrictions would no longer apply with respect to that security. The NYSE suggests, however, that certain types of new listings are essentially "technical" in nature, or may be designed to prevent avoidance of exchange listing requirements, including the payment of appropriate listing fees.

<sup>73</sup> See Release, *supra* note 8, at 16-17, 44 FR at 26691.

<sup>74</sup> Proceeding Transcript, *supra* note 21, at 230. In the Release, the Commission also requested comment on whether the Rule, if adopted, would or would not provide any incentives for exchange listings. Release, *supra* note 8, at 18-19, 44 FR at 26691. The Commission received little comment on this issue, and commentators were either divided on the question or unsure as to whether the Rule would have any impact on exchange listings. See, e.g., Proceeding Transcript, *supra* note 21, at 285-87, 831-32. As a result, it appears that the possible effects of the Rule in this area are uncertain.

<sup>75</sup> See Release, *supra* note 8, at 18, 44 FR at 2669.

<sup>76</sup> See *id.*

<sup>77</sup> Proceeding Transcript, *supra* note 21, at 632-34, 668-70, 1006-07, 1038-39.

<sup>78</sup> See, e.g., *id.* at 11-12.

<sup>79</sup> Proceeding Transcript, *supra* note 21, at 803-10.

<sup>80</sup> See text accompanying note 20, *supra*.

For example, the NYSE indicates that it may require a new listing because of material changes in the features of a particular security, *e.g.*, changes which alter its rights, privileges or terms in a material way, or as a result of application of its so-called "back door" listing policy.<sup>81</sup> The NYSE argues that such new listings are, in effect, continuations of trading of previously listed securities and that, as a result, the Rule should be amended such that off-board trading restrictions would continue to apply to such securities after listing.

The Commission shares the concerns expressed by the NYSE and recognizes that there may be certain, relatively infrequent, types of corporate changes which currently result in new listings but which do not fundamentally change the investment or trading characteristics of a particular security and may appropriately be considered, for purposes of the continued application of off-board trading restrictions, as a continued listing of a security. However, because the Rule could not address every possible instance in which off-board trading restrictions should arguably continue to apply, it seems more appropriate for each exchange to address any such matters in the context of its own listing requirements and fee schedules, consistent with the requirements of Section 19(b) of the Act.

(3) The NYSE expressed its concern that the issuance of additional shares of a "covered security" may be subject to the Rule, *e.g.*, where additional shares of a covered security are issued pursuant to a stock dividend or stock split. The Commission believes that the Rule is clear on this point—if additional shares of a covered security are issued those shares would also be covered securities for purposes of the Rule and therefore would continue to be subject to any off-board trading restrictions then in effect, provided that the other requirements are met with respect to the definition of a covered security.

b. In addition, the Commission believes that it would be appropriate to make one technical change to the Rule. Paragraph (b)(3)(iii) of the Rule defines "covered security" to include, as an exception to the Rule, securities listed and registered on an exchange after April 26, 1979, provided those securities are issued in connection with a statutory merger, consolidation or similar plan of reorganization in exchange for other

securities which are covered securities. The Commission has modified the paragraph to make clear its intent that this exception shall apply to such securities only if they remain listed and registered on at least one exchange continuously thereafter.

### III. Monitoring Program and Public Comment

Resolution of many of the issues raised by commentators may be significantly aided through empirical observation and evaluation. Accordingly, the Commission has developed a program to monitor the operation and effects of the Rule on an ongoing basis. The essential elements of this program are data collection, data analysis (including the use of econometric methodologies) and review of empirical findings in the context of the policy issues raised by the Rule's operation.<sup>82</sup>

The primary focus of the Commission's monitoring program will be upon the impact of the Rule on (1) market quality, (2) quality of executions, and (3) market structure. The Commission's monitoring effort will collect and produce data which will be used to describe the composition of the Rule's trading environment. For example, data on the number of market makers in Rule 19c-3 Securities and the distribution of volume among such market makers will be generated by the monitoring program. The following are examples of the types of methodology which will be used in the monitoring program.

#### A. Impact on Market Quality

Assessment of the impact on the quality of the market of trading resulting from the adoption of the Rule will be based primarily on three measures—the bid-ask spread, the quoted depth and the volatility of price. The methodology which will be employed to evaluate the impact of the Rule on these measures of market quality will be based primarily on published research and internally developed models which have been previously tested. Control groups of non-Rule 19c-3 Securities will be used in the testing process in order to better isolate the Rule's impact. All analyses of the impact of the Rule on market quality will be based on samples of securities

for sample time periods, *e.g.*, non-Rule 19c-3 Securities, Rule 19c-3 Securities listed before the effective date of the Rule and Rule 19c-3 Securities listed after the effective date of the Rule.

#### B. Impact on Quality of Execution

The impact of Rule 19c-3 on the quality of executions will be monitored in order to determine the extent of overreaching in connection with the execution of internalized orders by retail broker-dealers. In addition, the quality of executions with respect to non-internalized agency orders will also be monitored.

The quality of executions in Rule 19c-3 Securities will be monitored utilizing a sampling methodology by comparing the prices of agency orders to the quoted market at the time the order was executed.<sup>83</sup> In addition, control groups of non-Rule 19c-3 Securities will be established to enable comparison of market characteristics such as the percent of orders executed within the bid-ask spread and the percent of orders executed at the quoted market.

#### C. Impact on Market Structure

A fundamental characteristic of all markets is the number of competitors. Empirical data will be gathered which will indicate the impact of the Rule on the number of market makers entering quotes in Rule 19c-3 Securities. In addition, the monitoring program will include an analysis of trading patterns that develop in the new trading environment in order to assess the Rule's impact on the distribution of volume among participants.

In addition to obtaining empirical data on the number of market makers and on the distribution of volume, the monitoring program will evaluate the Rule's impact on smaller broker-dealers by observing the degree to which such broker-dealers continue to make markets in Rule 19c-3 Securities. Data will also be gathered with respect to market maker quotations in Rule 19c-3 Securities, as well as the size of the quotes being offered by market makers.

Finally, as experience is gained under the Rule, the Commission may determine to alter or expand the scope of the monitoring program in order to evaluate the economic impacts of the Rule on various market participants and on the market structure as a whole.

#### D. Public Comment

It is anticipated that the results of the Commission's monitoring program will

<sup>81</sup> The Commission understands that the "back door" listing policy generally requires a company to delist its securities in the event that a large unlisted company is combined with the listed company and the listed company continues as the surviving entity.

<sup>82</sup> It is important to note at the outset that this monitoring program is subject to all the caveats applicable to empirical research. More specifically, the methods of statistical analysis employed in this program may introduce a margin of error which will limit the Commission's ability to draw definitive conclusions. Nevertheless, the Commission believes that its monitoring program will contribute to the clarification of some of the policy issues presented by the Rule.

<sup>83</sup> It should be noted that there are problems in both exchange and over-the-counter markets in determining the precise time at which an execution occurs or a quotation is made.

be publicly reported on a periodic basis. The first report will be issued approximately May 31, 1981. Two additional reports will be issued at twelve month intervals thereafter. The Commission believes that these public releases will facilitate informed comment on the advisability of further regulatory action concerning the Rule. In this regard, following the issuance of the first monitoring report, the Commission expects to hold a public meeting in which interested persons may comment on that report (including suggesting improvements in format or content) and generally on Rule 19c-3 and the market environment for Rule 19c-3 Securities.

In addition to comments regarding the periodic reports issued as part of the monitoring program, the Commission also solicits the views of interested persons on a continuing basis with respect to any aspect of Rule 19c-3. Moreover, because of the importance of the issues associated with the retention or elimination of off-board trading restrictions and the relationship of those issues to the evolving national market system, the Commission expects to reexamine the issues associated with exchange off-board trading restrictions generally, to the extent and at such times as appears appropriate in light of developments in the markets.

#### IV. Conclusion

As discussed above,<sup>84</sup> the Commission has found that off-board trading restrictions impose burdens on competition by limiting over-the-counter market making by exchange member firms. The adoption of the Rule will prevent the application of these burdens on competition to Rule 19c-3 Securities and may provide benefits in terms of preserving (and possibly enhancing) competition between and among markets. The adoption of the Rule may also provide a trading environment which may permit both the securities industry and Commission to make useful observations about the utility of an integrated trading environment in which both exchange and over-the-counter market makers are free to compete. The Commission recognizes that, as indicated by commentators, there are significant regulatory concerns with respect to the possible adverse consequences of adoption of this proposal. However, on balance, in the Commission's judgment, in light of the limited scope of the Rule, and the Commission's ability to take additional regulatory action, including rescission of the Rule if significant adverse consequences do occur, the potential

benefits of adoption appear to outweigh the potential adverse impacts of the Rule.

Accordingly, based on the record of this proceeding, the Commission has determined, pursuant to Section 19(c) of the Act, that the adoption of Rule 19c-3 is necessary or appropriate to conform the rules of exchanges to the requirements of the Act, or is otherwise in furtherance of the purposes of the Act.

In taking this regulatory action under the Act, Section 23(a)<sup>85</sup> requires the Commission to consider "the impact that rule or regulation may have on competition" and precludes the Commission from adopting any rule or regulation "which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act." Based on the foregoing analysis,<sup>86</sup> the Commission also finds that Rule 19c-3 does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

In view of the considerable concern which has been expressed by commentators with respect to the significance of Rule 19c-3 as a precursor to eliminating all remaining off-board trading restrictions, the Commission believes it is important to indicate the significant limitations it perceives regarding the predictive value of the experience which may be obtained under the Rule. As indicated above,<sup>87</sup> the Commission recognizes that the Rule may not yield results permitting extrapolation beyond the limited scope of the Rule. As a consequence, the Rule should not be viewed as a "first step" which, absent substantial negative effects, would inexorably lead to the elimination of off-board trading restrictions with respect to all reported securities. Similarly, with respect to the possible adverse consequences of adoption of Rule 19c-3 which have been advanced by opponents of the Rule, the Commission's adoption of the Rule should not be construed as indicating that these concerns might not be of greater significance in the context of a more general elimination of off-board trading restrictions, or that the Commission has definitively resolved the issues associated with any such action.

The Commission has determined that adoption of Rule 19c-3 is an appropriate vehicle for beginning to address the complex and difficult market structure

and investor protection issues involved in off-board trading by exchange member firms (particularly where such firms are permitted to act as both broker and dealer in the same security). The limited nature of the proposal and the Commission's commitment to a comprehensive monitoring effort, in our view, minimize any potential adverse effects and enhance the learning potential of this "experiment." In light of the Commission's determination to adopt Rule 19c-3, the Commission does not expect to take further action in the near future regarding off-board trading restrictions generally.<sup>88</sup> Accordingly, the Commission has determined to withdraw proposed Rule 19c-2 simultaneously with the effective date of Rule 19c-3.<sup>89</sup>

#### V. Statutory Basis and Text of Rule

The Securities and Exchange Commission hereby amends Title 17, Chapter II, of the Code of Federal Regulations, pursuant to its authority under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq., as amended by Pub. L. No. 94-29 (June 4, 1975)), and particularly Sections 2, 3, 6, 11, 11A, 17, 19 and 23 thereof (15 U.S.C. 78b, 78c, 78f, 78k, 78k-1, 78g, 78s and 78w), by adding § 240.19c-3 to read as follows:

#### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

##### § 240.19c-3 Governing off-board trading by members of national securities exchanges.

The rules of each national securities exchange shall provide as follows:

(a) No rule, stated policy or practice of this exchange shall prohibit or condition, or be construed to prohibit, condition or otherwise limit, directly or indirectly, the ability of any member to effect any transaction otherwise than on this exchange in any reported security listed and registered on this exchange or as to which unlisted trading privileges on this exchange have been extended (other than a put option or call option issued by the Options Clearing Corporation) which is not a covered security.

(b) For purposes of this rule,

(1) The term "Act" shall mean the Securities Exchange Act of 1934, as amended.

(2) The term "exchange" shall mean a national securities exchange registered

<sup>84</sup> As indicated above, however, the Commission will consider immediate regulatory action to eliminate any adverse consequences of Rule 19c-3.

<sup>85</sup> See Securities Exchange Act Release No. 16889 (June 11, 1980). As indicated above, the Commission has determined not to withdraw proposed Rules 15c5-1[A], 15c5-1[B], 15c5-1[C] and 15c5-1[D]. See note 6, *supra*.

<sup>86</sup> 15 U.S.C. 78w(a).

<sup>87</sup> See text accompanying notes 17-81, *supra*.

<sup>88</sup> See text accompanying notes 21 and 82, *supra*.

<sup>89</sup> See text accompanying notes 11 and 17, *supra*.

as such with the Securities and Exchange Commission pursuant to section 6 of the Act.

(3) The term "covered security" shall mean (i) Any equity security or class of equity securities which

(A) Was listed and registered on an exchange on April 26, 1979, and

(B) Remains listed and registered on at least one exchange continuously thereafter;

(ii) Any equity security or class of equity securities which

(A) Was traded on one or more exchanges on April 26, 1979, pursuant to unlisted trading privileges permitted by section 12(f)(1)(A) of the Act, and

(B) Remains traded on any such exchange pursuant to such unlisted trading privileges continuously thereafter; and

(iii) Any equity security or class of equity securities which

(A) Is issued in connection with a statutory merger, consolidation or similar plan or reorganization (including a reincorporation or change of domicile) in exchange for an equity security or class of equity securities described in paragraph (b)(3)(i) or (b)(3)(ii) of this rule,

(B) Is listed and registered on an exchange after April 26, 1979, and

(C) Remains listed and registered on at least one exchange continuously thereafter.

(4) The term "reported security" shall mean any security or class of securities for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan.

(5) The term "transaction report" shall mean a report containing the price and volume associated with a completed transaction involving the purchase or sale of a security.

(6) The term "effective transaction reporting plan" shall mean any plan approved by the Commission pursuant to § 240.11Aa3-1 (Rule 11Aa3-1 under the Act) for collecting, processing and making available transaction reports with respect to transactions in an equity security or class of equity securities.

(Secs. 2, 3, 6, 11, 17, 19 and 23, Pub. L. No. 78-291, 48 Stat. 881, 882, 885, 891, 897, and 898 and 901, as amended by Secs. 2, 3, 4, 6, 14, 16 and 18, Pub. L. No. 94-29, 89 Stat. 97, 104, 110, 137, 146 and 155 (15 U.S.C. 78b, 78c, 78f, 78k, 78q, 78s and 78w); Sec. 11A, as added by sec. 7, Pub. L. No. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1))

By the Commission.  
George A. Fitzsimmons,  
Secretary.

June 11, 1980.

[FR Doc. 80-18394 Filed 6-17-80; 8:45 am]  
BILLING CODE 8010-01-M

## 17 CFR Part 256

[Release No. 35-21613]

### Income and Expense Accounts— Mutual Service and Subsidiary Service Companies

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is making a minor technical amendment of a single account in its Uniform System of Accounts for Mutual and Subsidiary Service Companies which will eliminate a requirement which is clearly inappropriate.

EFFECTIVE DATE: June 10, 1980.

#### FOR FURTHER INFORMATION CONTACT:

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Division of Corporate Regulation,  
Securities and Exchange Commission,  
500 North Capitol Street, Washington,  
D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission revised its Uniform System of Accounts for Mutual Service Companies and Subsidiary Service Companies under the Public Utility Holding Company Act of 1935 in Release No. 35-20910, 44 FR 8247, February 9, 1979. Upon implementation of the revised system of accounts, it was realized that gains or losses on disposition of operating equipment would be recorded in Account 421, Miscellaneous Income or Loss, and would, in fact, be the kind of transaction, arising repeatedly in the ordinary course of a service company's business, for which this account was most likely to be used.

The allocation prescribed by Account 421 was wholly unsuitable for gains or losses on disposition of operating equipment. Such gains or losses are directly associated with the cost of using the equipment. It is also clear that the allocation of gains or losses on any other kind of casual or extraordinary transaction should depend on the nature of the particular transaction and cannot reasonably be prescribed by a general directive.

Section 256.421, Miscellaneous income or loss, is being amended to eliminate the requirement that in all cases all income items in this account shall be credited to the associate companies on

the ratio of total direct and indirect charges billed and all loss items billed to the parent holding company. Unusual and sporadic transactions involved will be governed by Instruction .01-11, Methods of allocation, and Instruction .01-13, Submission of questions, in the context of relevant accounting principles.

The Commission finds that the amendment is minor and technical in nature and that publication for comment pursuant to Section 553(b) of the Administrative Procedure Act and related procedures are unnecessary.

### PART 256—UNIFORM SYSTEM OF ACCOUNTS FOR MUTUAL SERVICE COMPANIES AND SUBSIDIARY SERVICE COMPANIES, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Accordingly, 17 CFR Part 256 is amended by revising § 256.421 to read as follows:

#### § 256.421 Miscellaneous income or loss.

This account shall include all income or loss items not provided for elsewhere.

(Secs. 13, 15, 20, 49 Stat. 825, 828, 833; 15 U.S.C. 79m, 79o, 79t)

The amendment is effective immediately and applies to all transactions of service companies during the current fiscal year, including transactions occurring prior to the date hereof. Since the revised Uniform System of Accounts was not effective until January 1, 1980, the deleted requirement will have no application.

By the Commission.  
George A. Fitzsimmons,  
Secretary.

June 10, 1980.

[FR Doc. 80-18322 Filed 6-17-80; 8:45 am]  
BILLING CODE 8010-01-M

### EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

#### 29 CFR Part 1602

#### Records and Reports

AGENCY: Equal Employment Opportunity Commission.

ACTION: Notice of change (or modification) in Survey Form and Instructions, State and Local Government Information (EEO-4) report.

SUMMARY: Two changes in the EEO-4 have been voted by the Commission as follows: (1) revision of the earnings ranges on the form to reflect current earnings levels; and (2) eliminate the requirement that political jurisdictions